Office Supreme Court, U.S.
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Supreme Court of the United States

No. 424.

ELLA FRAD,

Plaintiff-Petitioner,

against

THE COLUMBIAN NATIONAL LIFE INSURANCE COMPANY,

Defendant-Respondent,

against

ELLA FRAD, as Executrix under the Last Will and Testament of WILLIAM D. FRAD, Deceased,

Third-Party Defendant.

Petition for Writ of Certiorari to the United States Court of Appeals for the Second Circuit, and Brief in Support Thereof.

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THE REPORTER COMPANY, INC., New York City—1951

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No.

ELLA FRAD,
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ELLA FRAD, as Executrix under the Last Will and Testament of William D. Frad, Deceased,
Third-Party Defendant.

PETITION FOR WRIT OF CERTIORARI

To the United States Circuit Court of Appeals, Second Circuit.

(Folio references are in parentheses preceded by the letter R. Most Complaint allegations referred to herein were expressly admitted by the Answer Par. 1 (R382). To avoid repetition, only the Complaint allegations and folio Record reference thereto will be cited. Where the Complaint allegation is answered otherwise, special reference is made to the answering paragraph and Record folio thereof.)

To the Honorable, the Chief Justice, and the Associate Justices of the Supreme Court of the United States of America:

Your petitioner, Ella Frad, respectfully petitions that a writ of certiorari issue to review the final decision of the United States Court of Appeals for the Second Circuit in the cause, entered on the 20th day of August, 1951 (R544), which reversed a judgment of the United States District Court for the Southern District of New York, entered October 2, 1950 (R6), and dismissed the complaint (R1519-1599).

The District Court judgment had reinstated three policies of life insurance on the life of the assured, her now deceased husband (surrender of which policies had been obtained by the insurer from a bank assignee, which held the policies as collateral security on a loan to the assured), and which judgment also granted the plaintiff, as named beneficiary, the death benefits provided in the policies, less the amount paid to the bank on surrender, and less the premiums which had remained unpaid from the time the insurer had refused to accept premium payments until the date of the assured's death. The District Court judgment also granted the defendant judgment against the assured's estate, on two money counterclaims for disability benefits fraudulently obtained by the assured under the policies, from which part of the judgment no appeal was taken.

This action was originally brought in the Supreme Court, New York County, New York, and was transferred by the defendant to the United States District Court for the Southern District of New York, on account of diversity of citizenship (R3).

Opinions Below.

The opinion of the District Court is reported in *Frad v. The Columbian National Life Insurance Company*, 85

Fed. Sup. 45, and is found in the Record (R1548-1590). The opinion of the United States Court of Appeals, Second Circuit, has not yet been reported, but will be found in the record (R537).

Basis for Jurisdiction.

Jurisdiction of this Honorable Court is invoked under *U. S. C. Title 28*, Section 1254 (1), and *Supreme Court Rule 38 (5) (b)*, in that:

1. The Court below decided an important question of New York State law as to rights and obligations under the life insurance policies, particularly as to the right of the assured and the bank assignee to receive a loan on the sole security thereof, and of the named beneficiary therein to receive the death benefits thereunder, which decision is in conflict with Insurance Law, §166 (1) (5) of the State of New York (quoted below, p. 29), and the decisions on the subject by the highest courts of New York State (cited below, p. 28).

2. The Court below decided an important question of New York State law, as to the rights of the assured, the beneficiary, and the assignee under three policies of life insurance, payable to a third party beneficiary, the widow, where the insurer wrongfully obtained surrender of three policies, in a case where the assured had obtained disability benefits by fraud, which decision is contrary to the state statute, *Insurance Law*, §166 (1) (5), and state court decisions, that expressly exempt the proceeds of the policies, especially the cash loan values and death benefits thereof, from the claim of the insurer for repayment of disability benefits so obtained by the assured, which question of law this Court never decided.

3. The Court below decided a federal question, as to rights of the beneficiary under life insurance policies, under state statutes and state decisions, in conflict with the decision in *Whitefield v. Aetna Life Insurance Co.*,

205 U. S. 489, which holds that the interpretation and application by the federal courts of state statutes, enacted for protection of the rights of beneficiaries under life insurance policies, should be in accordance with the interpretation and application thereof given by the courts of the particular state.

4. The decision by the Court of Appeals, Second Circuit, is in conflict with the decision of the Court of Appeals, Seventh Circuit, in *Missouri State Life Ins. Co. v. Langreader,* 87 Fed. (2) 810, as to the right of a beneficiary to bring an action to reinstate a policy of life insurance on her deceased husband and obtain the death benefits thereunder in such action, where the insurer wrongfully obtained its surrender from a bank assignee.

5. The decision of the Court below departs from the accepted and usual course of judicial proceedings, by failing to apply the state statutes and decisions of the highest court of the state, and reversed the Trial Court, whose determination conformed therewith in all respects, which is contrary to the express requirements of *U. S. C. Title 28,* Section 1652, and deprives the beneficiary of her constitutional right to due process of law.

Summary Statement of the Case.

In 1928 and 1929, William D. Frad obtained three life insurance policies from the defendant, in the face amount of $20,000, which carried disability provisions, and which were payable to a third party beneficiary; namely, Ella Frad, his wife, the plaintiff (Pltff's Ex. 5, 6 & 7; R, pp. 262-265). Thereafter, he developed a serious heart condition, which was totally and permanently disabling, according to the opinion of his own doctors (Plff's Ex. 12A, R839; Plff's Ex. 9, R814; Plff's Ex. 11A; P826; Plff's Ex. 28, R1044-1055; Plff's Ex. 26, R901-941; Plff's Ex. 27, R992-1043), and also according to the repeated opinions of defendant's own selected eminent heart specialists

(Plff's Ex. 22, R852; Plff's Ex. 23, R84; Plff's Ex. 24, R872-3; Plff's Ex. 25, R899). He applied for, and obtained, disability benefits from the defendant, which, in the two periods in issue, from December, 1935 to June, 1937, and from June 1939 to March 1940 (Def's Ex. B3; R1083-1085), totalled $7,524.30, being $5,600 in monthly disability payments, and $1,923.10 for waiver of premiums (R1588-89; Plff's Ex. 2, R759). (There was a period in between these two counterclaim periods, for which he was paid like benefits in the settlement of a City Court action, the validity of which settlement and payment is not questioned.)

While obtaining these disability benefits, the assured, despite all medical advice to the contrary, engaged in what the Court found constituted a gainful occupation. The insurer claimed, that despite his condition of health, which admittedly was totally and permanently disabling, and which he truthfully represented in his proofs of claim (Pltff's Ex. 11A, R821; Plff's Ex. 12A, R833), he was not entitled to receive the disability benefits, because he actually was engaged in a gainful occupation, and that in receiving the disability benefits while so engaged, despite his totally and permanently disabling state of health, he perpetrated a fraud on the insurer (Deft's. Ex. B-3; R1083-1085; Com. Ex. G; R115-117). The Trial Court granted the insurer judgment on the two money counterclaims, from which no appeal was taken. So, for the purpose of this litigation, it must be accepted that the assured received those disability benefits fraudulently.

Beginning with April 1940, when the payment of disability benefits were last stopped, to September 1942, the assured, on demand of the insurer (Com. Par. 41; R33), paid the premiums on the policies, which the insurer demanded and accepted (Com. Pars. 41, 42, 43, 44; R33-35), and for which it issued its premium receipts (Com. Par. 43; R34), and it retained those premiums until

September 1942 (Com. Par. 58; R57), a period of over two years. During all this time, the insurer admittedly knew that the assured obtained the disability benefits by the fraud claimed, for that was set up as a counterclaim by the insurer (Plff's Ex. 2; R756-763) in a Municipal Court action brought by the assured to recover disability benefits. (That counterclaim was subsequently discontinued there, so as to enable it to interpose that counterclaim in this action R586.)

In September 1942, defendant wrote the assured, that the disability benefits, which had been paid him, had been obtained by him by fraud, and that, therefore, it claimed the premiums which had been waived, by reason of such fraud, had actually remained unpaid, causing the policies to have lapsed since December 1935 and July 1936 (Deft's Ex. B-3; R1085; Com. Par. 57; R57). A copy of this letter was sent to the beneficiary (Deft's Ex. B-2; R1081).

At that time, September 1942, the assured's heart condition was such that it was obvious from the medical reports made by the insurer's own doctors, that the assured did not have long to live, and that the death benefits would inevitably be payable within a short time. (See especially, report of insurer's own heart expert, Dr. Comeau, made April 15, 1940; Plff's Ex. 25, at R899). The assured died about two years thereafter, September 16, 1944, "due to arteriosclerotic disease of 10 years," as was conceded (R485).

In December 1942, when the next premium fell due, the insurer rejected the premium payments then tendered, on the ground that the policies had lapsed since December 1935, and July 1936, respectively, and were "out of force" (Deft's Ex. B3; R1085), and stated it would not accept any further premium payments (Com. Par. 81R; Com. Ex. G, R157; Deft's Ex. E; R1096).

From December 1942 onward, defendant would not accept any further premium payments (Com. Par. 81R;

Ans. Ex. O; R157). So these premiums remained unpaid from December 1942 to the date of assured's death in September 1944, which unpaid premiums total $1,402.40 (R1587).

Meantime, in January 1941, the assured had applied to the Colonial Trust Company for a loan on the policies in the sum of $5,000 (see Com. Ex. N; R155; Com. Par. 80, R60), offering the policies as collateral security. The bank made inquiries of the insurer as to the status of the three policies, and was advised by the insurer, in writing, that they were in good standing, that all premiums thereon were paid up to date, and that they had a total cash loan value of $5,467.90 (Com. Pars. 47, 49; Ans. Exs. H, I & J: R118-130). As their cash loan value was above the amount of the desired loan, the bank made the loan on the policies, in reliance on those representations by the insurer.

In September 1942, when the insurer notified the assured and the beneficiary that it considered the policies lapsed, it sent a copy of that letter to the bank (Deft's Ex. B1; R1078; Deft's Ex. B-3; R1083; Com. Par. 59; R43). The bank thereupon requested the assured and the beneficiary to repay the loan, in the light of the information it had received from the insurer, that the policies were invalid security (see Deft's Ex. F at R1103). The policies then had an aggregate cash loan value, as of that date, in the sum of $6,525.30 (Deft's Ex. O; R1155, p. 385; and see Com. Par. 98; R78 for the details). The assured then requested a loan from the insurer of $5,000 (Com. Par. 80; R60; Com. Ex. N; R155), "to repay to the bank," and consenting that the "bank is to receive the check" (R155), which requested loan the insurer refused to make, claiming that the policies had lapsed, that whatever cash loan value there was in the policies was offset by its claim for the amount of the fraudulently obtained disability benefits, that the assured, therefore, had no equity left therein, and that there was

no cash loan value in the policies on which to make a loan (Com. Par. 82R; Com. Ex. P; R160). The bank itself also requested a loan from the insurer (Com. Par. 85R; Com. Ex. R; R169; Deft's Ex. G; R1105; Com. Par. 86; R66-69; Com. Ex. S; R174), and that was refused by the insurer both orally and in writing, on the very same grounds given to the assured (Deft's Ex. H at R1121). The insurer further advised the bank in that same letter and otherwise that the policies were invalid as collateral security and had no monetary value, by reason of the lapse and by reason of the alleged lien it had itself on the policies for the disability benefits, which had been fraudulently obtained from it (Deft's Ex. D; R1095), but that it would pay the amount equal to the cash surrender value, which was exactly equal to the cash loan value of the policies (Com. Par. 99; R78), for a complete surrender of the policies (Com. Par. 87; Deft's Ex. H, R1111, at R1121). It is admitted (Com. Par. 90; R72):

> "90. Upon information and belief, the defendant, through its attorneys and representatives, *advised the said Colonial Trust Company* at various times between December, 1942 and March, 1943, that said policies were lapsed for non-payment of the premiums, which had been waived, that defendant had a lien on the cash surrender values thereof in excess of those amounts and that, therefore, said policies were null, void, and of no effect, and worthless to plaintiff or the bank, and *that the defendant would not make any loan on the said policies, in any amount whatsoever, to either the assured, the beneficiary, or to the bank.*" (Emphasis supplied.)

The assured notified the insurer (Com. Par. 88R; and Com. Ex. T; R181), that it must under no circumstance accept a surrender of the policies, because the assured's obligation to the bank could be discharged by a loan on the policies, within the amount of their then cash loan values, and that the insurer was obliged to make the loan on the sole security of the policies under the pro-

visions of *Insurance Law*, Section 155 (1) (G), and under the decisions of the Court of Appeals on the subject; and that, in any event, it was estopped from refusing a loan to the bank, because of the fact that it had itself represented to the bank that the policies were good and valid at the time the loan was made by the bank, had stated that all premiums had been paid up to the time the information was given to the bank, and that all premiums had been paid since that time. The bank itself also wrote to the insurer, making the same statements, and also pointing out that it was estopped from refusing to make a loan, citing *Meeder v. Provident Savings Life Assur. Society*, 171 N. Y. 132, which is a leading case on this subject in the highest court of the State of New York (Com. Par. 86; R66; Com. Ex. S; R175). The insurer, however, refused to make the loan, and continued to make the representations stated above, as to the rights and obligations in the policies of the assured, the beneficiary, the bank assignee and the insurer (Com. Par. 90, R72-3).

The bank advised the assured that if it could not obtain a loan from the insurer, within 20 days after that notice, it would be compelled, *at some unspecified time thereafter*, to make a surrender of the policies (see Com. Ex. T at R182 and R184). The bank gave *no notice* to the assured that it ever *actually elected* to surrender the policies, or of the "time and manner" in which the surrender would be effected.

The insurer admitted to the bank (Deft's Ex. J, at R1132):

> "It is possible, of course, that upon notice (of an actually arranged surrender to be effected at a specified time and place) the insured or beneficiary may pay your client's loan and thus prevent surrender of the policies." (Matter in parentheses supplied.)

That is exactly what the assured's attorney, Mr. Griston, was seeking to arrange at the time, as is clear from Mr. Griston's talks with Mr. Lane, the insurer's attorney, and a reason why Mr. Griston wanted to be advised by the insurer what it finally intended to do about the loan request, so that he could guide himself, the assured and beneficiary, which information defendant's attorney, Mr. Lane, promised to give Mr. Griston, but which promise he admittedly did not keep (R496; 503; R570; Com. Pars. 95, 96, 97; R76-77; Com. Par. 111, 112, 113, 114, R84-85). The assured warned defendant insurer that obtaining a surrender from the bank would be at its own risk (Com. Ex. T; R183; Ans. Par. 27; R396).

Then, on April 24, 1943 (R570), the insurer secretly, and admittedly without notice to the assured or beneficiary (Com. Par. 111, R84), induced the bank to surrender the policies for the payment of $6,525.30, an amount equal to the then cash loan value (Deft's Ex. O; R1155), which also was equal to the then cash surrender value (Com. Par. 99; R78; also see policies; Plff's Exs. 5, 6 & 7), which the insurer advised the bank it was giving the bank as a courtesy, and not as an obligation under the policies, or under any legal obligation in relation thereto (Deft's Ex. H, R1120-1121; Deft's Ex. L, R1142 (p. 381).

The surrender of the policies was taken by the defendant, contrary to plaintiff's express directions (Com. Par. 88, R71; and Com. Ex. T; R181), contrary to defendant's established practice (Com. Pars. 109, 110R), without notification to the assured or the beneficiary (Com. Par. 111, R84), and, indeed, contrary to express warnings of plaintiff not to do so (Com. Par. 112R; and also see admission in Ans. Par. 27; R343).

The foregoing material facts are not disputed, are amply supported by the proof, and were adopted by both courts below in their respective opinions.

The Pleadings.

The assured thereafter brought this action to reinstate the policies and, pending the litigation, died. Thereupon, Ella Frad, the named beneficiary, was substituted as party plaintiff (R444). It was stipulated that if the policies were reinstated by the Court, she was entitled to receive the death benefits, and should receive judgment therefor (R450-451).

The insurer interposed a counterclaim for a declaratory judgment, that the policies' surrender was properly obtained (R402-5), and also interposed two money counterclaims for the disability benefits granted the assured (R397-402). Because of the assured's death, the estate of the assured was made third party defendant on these two money counterclaims (R459-470; R1550).

The District Court Opinion.

The District Court held that the insurer wrongfully had declared the policies lapsed for non-payment of the premiums, whose waiver had been obtained by fraud. It held that, actually, the premiums were waived, and that the insurer had a right to claim that it was thereby damaged by fraud to the extent of the $1,923.10 in premiums that had been waived, and the $5,600 monthly disability payments that it had made to the assured, for which total sum of $7,524.30 it had a claim against the estate of the assured. A judgment was given to the insurer against the estate of the assured for the amount of those disability benefits so paid (R1597), from which part of the judgment no appeal was taken.

The District Court further held that the policies remained in full force and effect by the waiver of those premiums, even though they had been fraudulently obtained, citing the decisions of the state's highest court on this point. It also declared that *New York Insurance Law*, Section 166 (1) (5) expressly provides that the

policies and all benefits and proceeds thereof, and the rights and interests therein of the assured and of the beneficiary, are exempt from the claims of creditors, and that the highest court of New York State had settled the principle that where an assured obtains disability benefits from an insurer by fraud, that the insurer has a claim for debt as a creditor against the assured, but that this claim, just as any claim of any other creditor, is barred from being offset against the policies, or beneficial rights or interests therein of the assured or the beneficiary. *The cases cited which made these holdings were both in law and in equity.* (*Standard v. Equitable Life Assurance Soc.*, 274 N. Y. 519; *Wilkes v. Equitable Life Assurance Soc.*, 289 N. Y. 63; *Orent v. Equitable Life Assurance Soc.*, 268 App. Div. 299; *Grauer v. Equitable Life Assurance Soc.*, 167 Misc. 30 [per Rosenman, J.].) The insurer's rights were limited to obtaining a judgment against the assured, for the amount of the fraudulently obtained disability benefits. (Citing the above cases, and also *Brennan v. National Equitable Investment Co.*, 247 N. Y. 486.) The debt could not be used to diminish either the loan value, or death benefits payable under the policies, which were exempt.

The District Court further held that the insurer, having wrongfully refused to make a loan on the policies, and having misrepresented the rights and liabilities therein of the various parties, and having thereby obtained the surrender of the policies from the bank assignee, that this was a wrongfully induced surrender, and that the policies should be reinstated, for otherwise, the insurer would be profiting by its own wrong, by being thereby relieved of its legal obligations under the policies. The Trial Court granted a judgment reinstating the policies, and awarded the beneficiary the death benefits, less the amount paid by the insurer to the bank for the surrender of the policies, and less the premiums that had remained unpaid from the time that the insurer had wrongfully refused to accept premium payments, until the date of the assured's death.

The Court of Appeals Opinion.

The Court of Appeals, with the exception of two legal points to be presently discussed, itself adopted the findings and principles of law laid down in the Trial Court's opinion. It agreed that under the settled New York State law, the fraudulently obtained waivers created a debt by the assured to the insurer for the amount thereof, but did not lapse the policies, and that the policies must be

> "for present purposes treated as having been in full force and effect at the time of their surrender."

It also held that:

> "The insurer, having represented to the bank before the loan was made that the policies were good security, may have been estopped to rely upon fraud in resisting the bank's demands (for a loan)."

Then the Circuit Court pronounced two doctrines on which it squarely based its decision, which is the crux of this appeal to this Honorable Court.

1. That though the policies were "in full force and effect at the time of their surrender," the assured's debt to the insurer for disability benefits fraudulently obtained could be offset by the insurer against the cash loan value of the policies, and as this debt slightly exceeded the cash loan value thereof, the assured had no equity left therein, and the insurer therefore did not have to make a loan to the assured; nor did the insurer have to make a loan to the bank, on the theory of estoppel, or on any contractual or legal obligation, because the assured and the beneficiary were not harmed by the insurer demanding a surrender of the policies and paying the bank the surrender value, instead of the cash loan value, which were identically equal, because neither the assured nor the beneficiary had any further rights or interests in the policies.

2. That as the insurer had not been repaid the amount of the disability benefits, fraudulently obtained, and as the beneficiary knew that the assured had been working while receiving disability benefits, and she, nevertheless, accepted from the assured, her husband, some of this money, that he received by way of disability benefits, to pay her current household expenses, that she was thereby barred, by the "clean hands" doctrine, from coming into a Federal Court and enforcing her rights to reinstate the policies, and to enforce her rights to the death benefits thereunder, even though the surrender of the policies was wrongfully obtained by defendant insurer.

Fundamental Basis of the Court of Appeals Decision.

In making these two holdings, upon which it squarely based its decision, the court below completely overlooked, or misapprehended, *New York Insurance Law*, Section 166 (1) (5), and those phases of the decisions of the highest courts of the State of New York, in *Wilkes v. Equitable Life Assurance Society, supra, Standard v. Equitable Life Assurance Soc., supra,* and *Orent v. Equitable Life Assurance Soc., supra,* which settled the law that none of the rights or interests of the assured and of the beneficiary under the policies, where there is a third party beneficiary, particularly the cash loan and the death benefits thereunder, are in any wise to be effected, diminished, or impaired, by the claim that the insurer has against the assured for disability benefits fraudulently obtained, and that the policies must be left in full force and effect, with all monetary rights thereunder intact, and that the death proceeds must be paid to the beneficiary in full when demanded, without any diminishment. It also ignored the holding in *Brennan v. National Equitable Investment Co., supra.* (For exact language of the statute and for the discussion of the cases, see below, p. 28.)

By reason of the two principles that the lower court laid down, both of which stem from the failure of the lower court to apply the *New York Insurance Law,* Section 166, (1) (5), and the New York Court of Appeals decisions in relation to those rights, it has violated the rights of the assured, of the beneficiary, and of the assignee, that the legislature of the State of New York and the highest court of the State of New York had set up for the protection of the assured, the beneficiary, and the assignee, as to their respective rights under the policies of life insurance, payable to the third party beneficiary, and violated her rights thereunder contrary to the express requirements of *U. S. C. Title 28,* § 1652.

By the same failure to apply *Insurance Law,* Section 166 (1) (5) and the New York State Court decisions in relation to the related rights, the Court below overlooked or misapprehended their holdings, that as at the time the surrender of the policies was obtained, they being undisputably "in full force and effect at the time of their surrender," *they retained their full cash loan value,* and that, therefore, the loan should have been made on the policies either to the bank, or to the beneficiary, on their respective demands under the express requirements of *New York Insurance Law,* Section 155 (1) (G), the holding in the case of *Del Rio v. Prudential Ins. Co.,* 259 N. Y. 135, and, indeed, the provisions of the policies themselves (see Com. Par. 78, R59). Had that loan been made to either, as the insurer was bound to do by New York statutes and decisions of New York State's highest court, there would have been no surrender of the policies, and no occasion for the defendant to induce the bank to surrender them.

Also, by the same failure to apply the provisions of *New York Insurance Law,* Section 166 (1) (5), and the highest court decision, of *Wilkes* case, *supra,* and *Standard* case, *supra,* exempting the cash loan values and death benefits in the policies from any debt that the assured owed the insurer for the fraudulently obtained disability

benefits, the fact, that the insurer did not receive repayment of that debt, could not be used as a ground under the "clean hands" doctrine, for destroying the policies, or depriving the beneficiary of her right to come into court to enforce her rights under the policies, because to deprive her of the right to go into court to enforce the policies, and to enforce her rights to the death benefits, would be taking from her that which the New York statute, *Insurance Law,* Section 166 (1) (5), and the New York highest court squarely held should be left intact and undisputed, and should be paid to her in full. As a result, by that statute and those decisions of New York State's highest court, the "clean hands" doctrine is barred as a defense to plaintiff's cause of action, in either law or equity.

This is particularly true, in view of the fact that there was no wrong committed by the beneficiary in the negotiations and representations whereby the insurer induced the bank to surrender the policies, for throughout those dealings, both she and the assured continually warned the bank not to do so, that the loan on the policies was sufficient to discharge the assured's debt to the bank, and advised it, orally and in writing, that if it did obtain a surrender, it would be at its own risk, for which it would be held strictly responsible (Ans. Par. 27R, Com. Ex. T, R183; Com. Par. 88; R71).

Besides, in order to apply the "clean hands" doctrine at all, the wrong of the litigant that could be set up as a bar to the action, must have occurred in the very transaction of which the litigant complains, in her own cause of action, and this undisputably never occurred, for the insurer in wrongfully inducing the surrender of the policies, acted contrary to the demands and warnings of both the assured and the beneficiary. Even the assured's obtaining of the disability benefits occurred between two and five years *prior* to the defendant's transactions with the bank, whereby it wrongfully obtained the surrender of the policies from the bank assignee.

The Court below, therefore, deprived the beneficiary of her rights under the New York State statutes and New York State court decisions, contrary to the express requirements of *U. S. C. Title 28*, Section 1652, and contrary to her constitutional right of due process of law.

In *Whitefield v. Aetna Life Ins. Co.*, 205 U. S. 489, a Missouri statute was involved, which barred suicide as a defense to a death claim under a life insurance policy. The Circuit Court had applied a policy clause, which provided that on suicide only "ten per cent" of the face of the policy should be paid, and at the same time the Court so interpreted the statute as to vitiate its effect, contrary to the application of the statute made by the highest state court. This court granted certiorari, reversed the judgment, and made an observation which is here squarely applicable (p. 496):

> "In this way (the interpretation made by the Circuit Court) the statute could be annulled or made useless for any practical purpose."

This Court also held that the State Statute as interpreted by the State Court must be followed by the decisions in the Federal Courts.

Furthermore, in the case at bar, the Court below, in holding that where the surrender of the policies was wrongfully obtained by the insurer, the beneficiary could not come into a federal court of equity, have the policies reinstated, and recover the death benefits, less the amount paid to the bank assignee for the surrender, and less the premiums which remained unpaid at the date of the assured's death, was making a decision directly in conflict with that of the Seventh Circuit in the case of *Missouri State Life Ins. Co. v. Langreader*, 87 Fed. (2) 810 (C.C.A. 7). This, therefore, creates a conflict of decisions in the Federal Court of Appeals, as to a principle of law which is of vital importance to all policy holders and their beneficiaries and assignees throughout the country.

This is a vital decision for the policy holders not only in New York State but also in the country. This decision sweeps away a large body of law established not only by the highest court of the State of New York, but similar holdings by the highest courts of the states throughout the country, which have enacted statutes for the protection of assureds, their beneficiaries and assignees, and of their various rights under the policies.

Questions Presented.

1. Where a bank holds three life insurance policies, as collateral to a loan made by it to the assured, in which policies the wife is third party beneficiary, and where the insurer induces the bank to surrender these policies for payment to it of an amount equal to the cash surrender value, by wrongfully refusing to make a loan on the policies to pay off the assured's debt to the bank, and by misrepresenting the rights and liabilities under the policies of the assured, the beneficiary, the assignee and the insurer, by which surrender, so obtained, the vested rights of the beneficiary are destroyed, and, the assured having died after the surrender so obtained, does the beneficiary have a cause of action to reinstate the policies, and to enforce her rights thereunder for the death benefits?

2. Where the assured obtains disability benefits from the insurer "fraudulently", because, despite a totally and permanently disabling heart condition, he, contrary to medical advice, engages in an occupation, while collecting disability benefits, and the assured has not repaid to the insurer the amount of those disability benefits, is the beneficiary barred in a Federal Court of Equity, by reason of the "clean hands" doctrine, from bringing an action to reinstate the policies, whose surrender the insurer wrongfully obtained from the bank assignee, and is she barred from recovering in such an action the death benefits, where the *New York State Insurance Law*, Section 166 (1) (5), and the decisions of the highest New York State

court hold that neither the policy, payable to a third party beneficiary, nor any right or interest therein of the beneficiary, particularly the cash loan value and death benefits thereof, may, in any wise, be effected adversely or diminished by any claim the insurer has against the assured as a creditor, nor by its claim for the amount of disability benefits paid the assured, even though fraudulently obtained by the assured?

3. Where the assured of three policies, payable to a third party beneficiary, obtains disability benefits from the insurer fraudulently, and the insurer has advised a bank assignee before making the loan to the assured, that the policies are valid, with all premiums paid to date, and has a cash loan value in excess of the amount of a loan the insurer makes to the assured on the policies on those representations, and where the premiums are paid thereafter, until further payment is wrongfully refused by the insurer, may the insurer, on the bank assignee's request for a loan, refuse to recognize the policies' validity, refuse to recognize the exemption provisions of *Insurance Law*, §166 (1) (5) and the state court decisions in relation thereto, and refuse to make a loan thereon contrary to the provisions of the policies, the requirements of *New York Insurance Law*, Section 155 (1) (G), and the decisions on these rights and obligations by New York State's highest court?

4. Where the insurer unilaterally declared the policies lapsed for alleged nonpayment of premiums, on the ground that the waiver thereof was obtained by fraud, where under the rulings of the highest court of the State of New York, this does not lapse the policies, and where the insurer wrongfully, and contrary to the provisions of the policies, and contrary to *New York State Insurance Law*, Section 155 (1) (G), and contrary to the decision of the highest court of the State of New York, refused to make a loan to the assured, or to the bank assignee, on the policies, to pay off the assured's indebtedness to the

bank, and where the insurer refused to apply *Insurance Law*, §166 (1) (5), misstated the rights of the assured, the beneficiary, the assignee and the insurer, and thereby induced the surrender of the policies, is such a surrender binding in the Federal Court on the beneficiary, whose vested rights to the death benefits were destroyed by that wrongfully obtained surrender?

5. Where the *New York State Insurance Law*, Section 166 (1) (5) bars a creditor from claiming a lien on a life insurance policy, payable to a third party beneficiary, or its proceeds, and where the highest court of the State of New York has held that no claim for debts that the insurer has against the assured, for fraudulently obtaining disability benefits, may be enforced on the policies, or the beneficial rights thereunder of the assured or the beneficiary, by the insurer, in either law or equity, may the Federal Courts refuse to apply the New York State statute and the decisions of the New York State's highest court in relation to those rights, and declare, contrary thereto, that it is inequitable to require the insurer to reinstate policies, whose surrender was wrongfully obtained by the insurer, where the insurer has not been repaid the debt owing to it by the assured for the disability benefits he had fraudulently obtained from it under the policies? And is not the principle of this decision in conflict with the principle this court settled in *Whitefield v. Aetna Life Ins. Co.*, 205, U. S. 489, that the State Court interpretations of state insurance statutes, enacted for the benefit of beneficiaries, are controlling in the decisions of the Federal Courts.

6. Where the Federal Court of Appeals fails to grant the beneficiary of the three life insurance policies the protection of her rights thereunder, expressly provided by the *New York Insurance Law*, Section 166 (1) (5), and the principles of law in relation to such rights, as established by the highest court of the State of New York, that no claim against the assured for fraudulently obtained

disability benefits may effect her rights, particularly the death benefits payable to her, and where the decision of the Federal Court of Appeals is directly contrary to those express statutory provisions and express holdings of New York State's highest court, does not that decision deprive the plaintiff beneficiary of her rights under the state statutes and decisions, in violation of the intent and meaning of *U. S. C. Title 28*, Section 1652, and of her constitutional right to due process of law?

7. Where the Court of Appeals, Second Circuit, holds that the policies, where surrender was wrongfully obtained, may not be reinstated in a declaratory judgment action brought by the beneficiary, and a judgment given therein to her for the death benefits, less the amount paid to the bank on the surrender, and less the amount of unpaid premiums from the date that premium payments were wrongfully refused, to the date of the assured's death, is not that decision contrary to the decision by the Seventh Circuit Court made in the case of *Missouri Life Insurance Company v. Langreader*, 87 F. (2) 810, and does not this create a conflict of decisions in the Federal Courts of Appeal on a principle of law which effects the rights of all assureds, beneficiaries and assignees, of every life insurance policy?

Specification of Errors.

1. The Court below erred in holding that a debt for disability benefits which assured owes insurer, may be used to reduce the cash loan value of a policy payable to a third party beneficiary, and to wipe it out, where the New York State statute provides, and New York State decisions of the highest court hold, that where the policy is payable to a third party beneficiary, the policy proceeds, expressly including the cash loan value and death benefits, are exempt from such a debt, either in law or in equity.

2. The Court below erred in holding that the bank's application for a loan was properly refused by the insurer, even though the policies were at that time "in full force and effect" and even though the insurer was estopped from refusing the loan to the bank on the policies and denying the policies' validity, having represented to the bank, before it made the loan thereon, that they were valid and had a cash loan value, with all premiums paid to date, and where all further premiums were paid as they fell due, until the insurer wrongfully refused to accept any further premium payments.

3. The Court below erred in holding, contrary to *New York Insurance Law*, Section 155 (1) (G) and the decisions of New York State's highest court, that the insurer did not have to make a loan on the policies to the assured, or to the assignee, for the policies, payable to a third party beneficiary, were in full force and effect, and by *New York Insurance Law*, Section 166 and the New York State cases, their cash loan value was exempt from any claim of the insurer for the amount of the disability benefits fraudulently obtained from it by the assured.

4. The Court below erred in holding that the assured had no equity in the policies at the time the surrender was obtained by the insurer from the bank, where, by the decisions of the highest court of New York, the policies were "in full force and effect," and where by State statute and the decisions of the State's highest court, their monetary values to the assured, beneficiary and assignee were exempt from the claims of creditors of the assured, including the claim of the insurer for disability benefits fraudulently obtained by the assured.

5. The Court below erred in holding the insurer committed no wrong in refusing the loan on the policies to the assured, on the ground that the assured had no equity therein, when by State statute and decisions of the State's highest court, the policies were then "in full force and effect," the cash loan value thereof remained

undiminished, and the cash loan value, and also the death benefits payable to the beneficiary, were exempt from any claims the insurer had against the assured.

6. The Court below erred in holding that no harm was done the assured or beneficiary under the policies, when the insurer induced the bank to surrender the policies, by refusing to make a loan thereon, and by representing that the policies had lapsed, that assured had no loan value therein, and that it (the insurer) had a lien thereon for disability benefits wrongfully obtained from it by fraud, when under the State statutes and decisions of the State's highest court, the refusal to make the loan was wrongful, and these representations were false, and the policies were "in full force and effect," with their cash loan values unimpaired in an amount greater than the amount of the loan requested.

7. The Court below erred in holding the third party beneficiary could be barred from suing in a Federal Court to reinstate the policies, whose surrender was wrongfully obtained by the insurer, and to recover death benefits thereunder, because the insurer did not receive repayment of the disability benefits it had paid the assured by the assured's fraud, where under the New York State statute and the State court decisions, such a debt claim could not in any wise be used to adversely effect or diminish the policies or the rights of the beneficiary to the death benefits thereunder.

8. The Court below erred in holding that the policies could not be reinstated and equity done the insurer by awarding death benefits to the third party beneficiary, less the amount paid by the insurer to the bank for surrender, and less the amount of unpaid premiums up to the date of assured's death.

9. The Court below erred in failing to follow the ruling of this Honorable Court in *Whitefield v. Aetna Life Insurance Co.*, 205 U. S. 489,

10. The Court below erred in making a decision contrary to that rendered by the Circuit Court for the Seventh Circuit in *Missouri State Life Ins. Co. v. Langreader,* 87 Fed. (2) 810.

11. The Court below erred in failing to apply the requirements of *U. S. C. Title 28,* Section 1652, in failing to render a decision in accordance with the New York statutes on the subject, and the decisions of the highest court of the State of New York.

12. The Court below erred in failing to give the plaintiff the benefits of due process of law, by reason of the failure to apply the statutory provisions of the State of New York, the decisions of the highest court of the State of New York, and the provision of *U. S. C. Title 28,* Section 1652.

Reasons for Granting the Writ.

1. Thousands of policy holders have taken out policies of insurance upon the faith of the validity of *New York Insurance Law,* Section 166 and Section 155, which, as construed by the Court of Appeals, Second Circuit, destroys the legislative policy of New York State, as it has existed since the law was enacted in 1909, as interpreted and applied by the highest court of the State of New York; destroys the protection provided for beneficiaries particularly as to their right to receive the death benefits in full; and impairs the rights, benefits and protection of the policies so taken out.

2. Where the statute of New York State by Insurance Law, §166, and the decisions of the highest court of the state exempt the rights and interests of an assured and beneficiary of a policy payable to a third party beneficiary, expressly including the cash loan value and death benefits thereof, from any diminishment by claims of the insurer against the assured, for the amount of disability benefits, for which it has a judgment, because

such benefits were obtained from the insurer by fraud, the Federal Courts should not ignore those state statutes, and those state decisions, and should not hold, to the direct contrary, that such debt may be offset against the cash loan value of the policies, so that the insurer may refuse to make a loan thereon to the bank and to the assured. Nor should it hold that on the basis of such wrongful refusal to make a loan and by reason of misrepresentations as to its obligations, and as to the rights of the assured, beneficiary and assignee under the policies, the insurer may induce a bank assignee to surrender the policies, in order to obtain from the insurer the cash surrender value thereof in payment of that debt owing to the bank by the assured, where the amount of the cash loan value was more than sufficient to discharge the debt to the bank, without destroying the policies.

3. For the very same reasons, the Federal Court should not hold that because of the failure of the insurer to receive repayment of the amount of the disability benefits paid to the assured, the beneficiary is, under the clean hands doctrine, barred from coming into the Federal Court to reinstate the policies, whose surrender was wrongfully obtained by the insurer from the bank assignee, and obtain her death benefits thereunder, in accordance with the terms of the policies and the requirements of the Insurance Law of the State of New York, and the decisions of the State of New York, for by such ruling, the Federal Court is doing indirectly what the New York State statutes and decisions of the State Courts hold may not be done at all in law or in equity.

4. That the decision herein made by the Court of Appeals for the Second Circuit conflicts with the decision rendered by the Circuit Court of the Seventh Circuit in *Missouri State Life Ins. Co. v. Langreader,* 87 Fed (2) 810, which holds that where the surrender of a policy had been wrongfully obtained, the assured having died, the beneficiary may bring an action to reinstate the policy

and recover therein the amount of the death benefits, less the amount paid by the insurer to the bank assignee at the time of the policies' surrender, and less the amount of the premiums that had remained unpaid until the time of the assured's death.

5. That the failure of the Court of Appeals, Second Circuit, to grant the beneficiary the protections given to her expressly by the statutes of the State of New York, and by the decisions of the State of New York, which protect her rights and interests under the policy, payable to her as third party beneficiary, constitutes a deprivation of her rights under the State statutes and decisions, under *U. S. C. Title 28,* Section 1652, and of her constitutional rights to due process of law.

6. That the decision of the Court of Appeals, Second Circuit, places policy holders, including assureds, beneficiaries and assignees, at the arbitrary mercy of insurance companies, and makes the policies a delusion, and a snare, with particular benefits to the insurer to have the actions transferred, whenever possible, to the Federal Court which, as by this action, established principles of law which are contrary to the holdings of the State statutes and ruling of the State's highest court and contrary to the principle settled by this Honorable Court in *Whitefield v. Aetna Life Ins. Co.,* 205 U. S. 489.

7. The question presented is of great public interest; the enforcement of the legislative policy of the state is at stake; the validity of thousands of outstanding policies involved; and if the decision below is permitted to stand, it creates an inducement for insurers to bring actions on policies of life insurance into the Federal Courts, where the state statutes and decisions in relation thereto are not followed; and gives the insurer a vital weapon whereby to destroy life insurance policy rights indiscriminately.

Prayer.

Your petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of this Honorable Court, directed to the United States Court of Appeals for the Second Circuit, commanding that court to certify and send to this Court for its review and determination, on a day certain to be therein named, a full and complete transcript of the record and all proceedings, together with all original exhibits on file in that certain cause numbered and entitled on its Docket No. Civ. 22-372, Ella Frad, Plaintiff-Appellee, against The Columbian National Life Insurance Company, Defendant-Appellant, against Ella Frad, as Executrix under the last Will and Testament of William D. Frad, deceased, Third Party Defendant, and that the judgment of the United States Circuit Court of Appeals for the Second Circuit should be reversed by this Court, and that the judgment of the District Court should be reinstated, and that the petitioner have such other and further relief in the premises as this Honorable Court may deem just and proper.

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BRIEF AND ARGUMENT IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

POINT I.

The amount of disability benefits obtained by an assured by fraud constitutes a debt of the assured to the insurer, after and not before, a Court decides that such a debt is actually owing and grants a judgment therefor; and such debt may at no time be used to diminish the cash loan or other monetary value of life insurance policies, payable to a third-party beneficiary, as here, even after judgment, for the policies, at all times, remain in full force and effect, with all the rights of the assured, beneficiary and assignee unimpaired, by express provisions of Insurance Law, Section 166 (1) (3), and by decisions of New York State's highest court.

The Courts of the State of New York have settled the rule that, even where the fraud practiced by the assured in obtaining disability benefits is not merely technical, as here, but is deliberate and even criminal, it does not deprive the assured, the beneficiary or the assignee of the policies, payable to a third party as here, of the full protection of their respective rights thereunder, under the exemption prescribed by *Insurance Law*, Section 166. Those decisions were made by the Courts of the State of New York in law and in equity alike.

Wilkes v. Equitable Life Assur. Soc., 289 N. Y. 63, which modified and affirmed 262 App. Div. 73.

Standard v. Equitable Life Assur. Soc., N. Y. Law Journal, March 7, 1936 (Special Term Opinion), 292 N. Y. S. 180, aff'd 249 App. Div. 617; aff'd 274 N. Y. 519. (Equity action like the case at bar to reinstate the policy.)

Orent v. Equitable Life Assur. Soc., 268 App. Div. 299; modified on a practice point, 268 App. Div. 1005.

Grauer v. Equitable Life Assur. Soc., 167 Misc. 30 (decision per Rosenman, J.).

Insurance Law, Section 166 has various subdivisions relating to the exemptions of the various monetary rights of various types of policy holders under various types of policies, but only portions of the following three sections are material here:

> "Sect. 166. Exemption of proceeds and avails of certain insurance and annuity contracts.
>
> "1. If any policy of insurance has been or shall be effected by any person on his own life in favor of a third person beneficiary, or made payable, by assignment, change of beneficiary or otherwise, to a third person, *such third person beneficiary, assignee or payee shall be entitled to the proceeds and avails of such policy* as against the creditors, personal representatives, trustees in bankruptcy and receivers in state and federal courts of the person effecting the insurance. * * * *The term 'proceeds and avails' shall include death benefits,* cash surrender and *loan values,* premiums waived, and dividends, whether used in reduction of the premiums or in whatsoever manner used or applied, *excepting only* where the debtor has, subsequent to the issuance of the policy, actually elected to receive the dividends in cash. * * *
>
> "2. No money or other benefits payable or allowable under any policy of insurance against disability arising from accidental injury or bodily infirmity or ailment of the person insured, shall be liable to execution for the purpose of satisfying any debt or liability of the insured, whether incurred before or after the commencement of the disability, * * *
>
> "5. The term 'creditor' as used in this section shall include every claimant under a legal obligation contracted or incurred after the effective date of this chapter. * * *" (Emphasis supplied.)

Said sections, in various forms substantially alike, so far as is here material, have been in effect since 1909, and they in turn were derived from a somewhat similar statute which was enacted in 1892.

The principles of these exemptions are so firmly founded in the decisions of the State of New York, that frequently

the courts make the ruling prescribed by the statute without actually citing the statute itself. Uniformly, however, the Courts of New York State apply the exemption provisions of the statute in their full force and effect.

In the *Standard* case, *supra,* the Court of Appeals passed upon a state of facts, which, to all practical purposes, is identical to that here presented, in an action brought in equity to reinstate the policy, just as in the action in the case at bar. The assured there had contracted tuberculosis, and made a claim for disability benefits, on the ground that he was thereby totally and permanently disabled, which claim was approved. The insurer there had made a loan on the policy to the assured. After paying the disability benefits for some time, the insurer discovered that while the assured did have tuberculosis, he was not thereby totally and permanently disabled, as appeared from certain medical proof which it had obtained, and from the activities of the assured himself. Upon discovering this state of facts, the insurer gave notice to the assured that it was terminating the grant of disability benefits. In that very notice (unlike in the notice in the case at bar), it demanded that the assured pay the insurer within 31 days, the amount of the disability benefits theretofor granted, including the monthly payments made to the assured, and the amount of the premiums that had been waived, and further stated that upon failure of the assured to make such payment, the policy would be declared lapsed. The assured did not make such payment within that 31-day period, but immediately thereafter another premium fell due, which the assured tendered, and which the insurer refused to accept on the claim that the policy had lapsed. The insurer had meantime advised the assured that it had lapsed the policy, by reason of his failure to comply with the notice, and further informed him that the cash surrender value thereof had been applied by it to the discharge of the loan it had made to the assured, and that the policy was no longer in force and effect.

In the reinstatement action brought by the assured, the insurer counterclaimed for the amount of the disability benefits that had been paid to the assured.

The Court held that the policy was wrongfully declared lapsed, reinstated the policy and severed the money counterclaim of the insurer for trial, declaring that the insurer's claim for the disability benefits paid to the assured, by reason of the assured's misrepresentation, could not destroy the policy, or any of the assured's monetary rights thereunder, but that the insurer had to rely for repayment of such debt on the judgment which it might obtain, if successful, by the Court's determination on the money counterclaim.

It should be noted that the judgment there reinstating the policies was rendered on a motion for judgment on the pleadings, these facts appearing therein, which facts, in all material respects, are substantially like those here presented. That judgment was affirmed by the Appellate Division and by the Court of Appeals.

It is a leading case in the State of New York, and is frequently cited on the subject, (see for example *Grauer v. Equitable Life Assur. Soc.*, 167 Misc. 30, per Samuel Rosenman, J.).

The only opinion reported, as to those decisions in the *Standard* case is the one rendered in the Trial Court, which well summarized the settled New York rule on the subject:

> "Thus the action presents this issue—has the defendant the right to rescind the insurance contract for plaintiff's failure to repay to defendant the benefits and premiums theretofore allowed by the defendant?
>
> * * * * * *
>
> "Of course, if benefits were allowed by mistake, the defendant was created a common creditor and in a proper action therefor recovery might be had. This the defendant is attempting to do under its counterclaims.

"But the right to declare the policy forfeited for failure to refund? Certainly the defendant can exercise no rights not found in the contract. The policy yields no warrant for the defendant's course here pursued. The defendant led the plaintiff to believe that a forfeiture of his policy would not be incurred. In *Insurance Co. v. Eggleston* (93 U. S. 572), it was said at 577:

> 'Any agreement, declaration or cause of action, on the part of an insurance company, which leads a party insured honestly to believe that by conforming thereto a forfeiture of his policy will not be incurred, followed by the conformity on his part, will and ought to estop the company from insisting upon the forfeiture, though it might be claimed under the express letter of the contract.'

"The law does not favor forfeiture and will strive to avert such a devastating result unless the clear terms of the policy forbid and dictate otherwise (*Griffey v. N. Y. Ins. Co.*, 100 N. Y. 417; *Ram v. Home Ins. Co.*, 59 N. Y. 387; *Press Publishing Co. v. General A. F. & L. Ins. Corp. Lim.*, 160 App. Div. 537; 145 N. Y. S. 711, aff'd 217 N. Y. 648; *Arico v. Prudential Ins. Co.*, 241 App. Div. 826, 271 N. Y. S. 241).

"It is but giving utterance to a banality to hold that a policy of insurance is nothing more nor less than a contract between the insurer and the insured, and that it is to be construed according to its terms and intent. The courts will not go beyond the rights and privileges and penalties expressed in the contract, or reasonably implied therefrom, to work a forfeiture. Suppose the plaintiff is in no position to comply with the demand for payment after he had been pulled into the belief that he would not have to pay? I perceive no basis for the exercise of retroactive rights. *It seems to me that the defendant's insistence on the refund as a condition precedent to the continued aliveness of the policy was unreasonable and not permitted by any provision contained in the contract of insurance.*

"The defendant told the plaintiff he need not pay the premiums. The plaintiff acted on this expressed waiver. The defendant's change of mind could not completely abrogate all that had been done. The defendant says that it has proof sufficient to justify rescission of its decision to pay the benefits and waive the premiums in the future. But as to benefits already paid and premiums already waived —there has been no adjudication that they were paid and waived under a mutual mistake. *Recognition of a claim to benefits and forfeiture of the policy are entirely distinct. The defendant has gone outside the contract to impose terms and work a forfeiture.* When the policy was declared lapsed the premiums had been paid by the defendant itself." (Italics supplied.)

The principle of the *Standard* case, *supra*, was applied shortly thereafter by the Court of Appeals in the *Wilkes* case, *supra*, in which it wrote a memorandum opinion, wherein it modified the Appellate Division judgment on that very point, and expressly referred to *Insurance Law*, Section 166.

The assured there sued for disability benefits under 9 policies of life insurance, on the ground that he had contracted coronary disease and angina pectoris, which were totally and permanently disabling. The insurer had paid disability benefits on those policies for a period of five years. It then discovered that this disability had arisen prior to the issuance of 3 of the policies, whereupon it had stopped making disability benefit payments on all 9 policies and had declared the 3 policies lapsed for nonpayment of premiums, on the ground that the disability benefits, including the premium waivers, had been obtained by fraud, and that the application for the policies made by the assured had been fraudulent. The insurer recognized that it was obliged to make the disability payments under the 6 other policies, but claimed that it had a right to offset against those disability payments owing the assured, on those 6 policies, the debt that the assured owed to it for the disability benefits that the assured had fraudulently obtained under those 3 policies.

In the action that the assured had brought to recover the disability payments under all 9 policies, the insurer interposed an equitable counterclaim to have those 3 policies declared lapsed for non-payment of premium, by reason of the fraudulently obtained benefits that had been granted on those 3 policies.

The Appellate Division held that even though the disability benefits were wrongfully obtained, the policies did not thereby lapse, and reinstated the policies. It, however, held that the amount of disability benefits wrongfully obtained on the three policies, could be offset against the amount owing to the assured for disability benefits already accrued, and those payable in the future.

In the Court of Appeals, the insurer raised the very point that was raised here, that it would be inequitable to compel the insurer to pay disability benefits on the 6 policies, and not be allowed to offset the disability benefits that had been fraudulently obtained under the other 3 policies, whereas the assured pointed out the *Insurance Law*, Section 166 covered that situation and barred such a set-off. The Court modified the judgment of the Appellate Division in that very respect, and held as follows:

> "The defendant may not be permitted to collect this money award out of disability benefits already due or as they become due under the 6 uncontested policies. That would be violative of Chapter 626 of the Laws of 1934, now in substance embodied in subdivisions 2 and 5 of Section 166 (formerly Section 55B) and the Insurance Law, Consolidated Laws Chapter 28."*

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* The Court below, in passing, mentioned *Apter v. Equitable Life Assurance Society*, 271 N. Y. 653. That case merely stands for the proposition that, after the insurer stops paying disability benefits and gives notice it has withdrawn the waiver of premiums, and assured fails to pay, or even tender, a premium falling due *thereafter*, the policy will lapse for non-payment of *that particular premium*. This was carefully explained in *Wilkes v. Equitable Life Assurance Society*, 262 App. Div. (N. Y.) 73, p. 76, wherein that ruling of the *Apter* case was distinguished from the principle being settled in the *Wilkes* case, and that Appellate Division explanation met with the full approval of the (N. Y. Court of Appeals in *Wilkes v. Equitable Life Assurance Society*, 289 N. Y. 63. The *Apter* ruling has no bearing at all on the issues involved in the case at bar.

In the *Orent* case, *supra*, the assured, together with a doctor and a lawyer, had connived to have the assured, by the aid of certain medicines and other practices, to pretend a totally and permanently disabling heart condition, as a result of which he received disability benefits under a life insurance policy. After the payments had been made for some time, the conspiracy was discovered, the culprits indicted, prosecuted and convicted of that very crime. The insurance company lapsed the policies on the ground that the waiver of premiums had been obtained by criminal fraud, and on the further ground that the cash loan values of the policies had been wiped out by offsetting the amount of the disability benefits which had been obtained by such criminal fraud. The Court held that despite the criminal fraud, the policies were wrongfully declared lapsed, reinstated the policies and held that the amounts of disability benefits obtained by this criminal fraud could not be offset by the insurance company against the monetary values of the policies.

In that action, the insurer interposed an equitable counterclaim that the declared lapse should stand, because the insurer had not received repayment of the disability benefits that had been obtained from it by criminal fraud of the assured. The Court there held that that defense was without merit.

That is the very point on which the Court below rendered its decision, *exactly contrary to the square ruling made in that case*, and contrary to the rulings made by the New York Court of Appeals in the *Standard* case, *supra*, and in the *Wilkes* case, *supra*.

Peculiarly, in the case at bar, the Court below recognized the well settled rule in the State of New York, that even where disability benefits are obtained by fraud of the assured, that the insurer has no right to declare the policy lapsed, and that the only right the insurer has is to elect to whether it will rescind the disability approval transaction and ask for the payment of the premium as a premium or treat the waiver as binding and

hold the assured for the amount of the waived premiums in an action for debt as damages suffered by the fraud, but cannot do both, and whichever election is made is conclusive, *Brennan v. National Equitable Investment Co.*, 247 N. Y. 486; *Robb v. Voss*, 155 U. S. 13, pp. 41-43; *Conrow v. Little*, 115 N. Y. 387, pp. 393-4.

The lower court also recognized that here the insurer decided not to demand payment of the waived premiums and did not do so, but instead elected to sue for damages (R756-763). The lower court says so plainly and squarely in its opinion. The insurer could thereafter never demand payment of premiums, as premiums, and it admittedly never did (Com. Par. 61; R44, admitted by Ans. Par. 6; R385). The Court below recognized this and expressly so stated in its opinion.

So the only right that the insurer had was to recover the amount of the premiums that had been waived, as part of its claim against the assured for damages suffered by the fraud. *Brennan v. National Equitable Investment Co.*, 247 N. Y. 486. They are part of the claim for disability benefits wrongfully obtained. Defendant did receive a judgment against the assured's estate for the total amount of disability benefits paid, including the amount of the premiums waived (R1587 and R1597).

The Court below having recognized that settled rule and those facts, apparently overlooked, or misapprehended, the provisions of *Insurance Law*, Section 166(1) (5), and in reading the cases which settled the rule that the policies did not lapse, where premium waivers were obtained by fraud, the Court below apparently misapprehended, or overlooked, the other rulings made in those very cases, that the amount of such debt, for disability benefits obtained by fraud of the assured, both as to monthly payments and premiums waived, could not be offset, or in any wise used to destroy the policies, or any benefits thereof, even in an action brought by the assured himself, the wrongdoer.

Certainly, under the well settled authorities of the highest courts of the State of New York, and the express provisions of *New York Insurance Law,* Section 166 (1) (5), such a claim that the insurer has against the assured, for disability benefits fraudulently obtained, could not be used in a Federal Court, no more than it could be used in the state courts, to bar the beneficiary from her rights under the policies, and from recovering her full death benefits, as therein provided. *U. S. C. Title 28,* Section 1652. *Whitefield v. Aetna Life Ins. Co.,* 205 U. S. 489. (See discussion of this case, *post,* pp. 39 and 40.)

POINT II.

The refusal to make a loan to the bank or to the assured, to pay off the assured's debt to the bank, was a violation of the terms of the contract itself, of the provisions of New York Insurance Law, Section 155 (1) (G), and of the decision of the state's highest court, for the policies were in full force and effect at the time, and their cash loan value remained unimpaired by reason of Insurance Law, Section 166 (1) (5), which statute the Court below either overlooked or misapprehended.

The Court below has recognized that:

> "for present purposes they (the policies) must be treated as having been in full force and effect at the time of their surrender."

The Court below, however, held further, as follows:

> "While the premium waivers did keep the policies in force, neither those waivers nor the disability payments were benefits to which the insured was entitled under the policies. *Instead, they are to be now treated in equity as advances he had obtained on the policies without right and as a debt owing by Frad to the insurer. As such, they were*

proper charges under the terms of the policies against the accumulations known as the cash and loan values, and decreased those values pro tanto. (Italics supplied.)

"Each policy provided expressly that:

'If there be any indebtedness to the Company *on this policy* including any unpaid premium or portion thereof to the date of lapse or surrender, the Cash and Loan Values will be diminished thereby, * * *'

"This indebtedness as of the time the insurer refused to make a loan on the policies amounted, without interest, to $5,600 for disability payments made, and to $1,923.10 for premiums, making a total of $7,524.30, which substantially exceeded the combined loan values the policies would otherwise have had (i. e., $6,525.30, Deft's Ex. O; R1155, p. 385; Com. Par. 78; R59; see also Com. Par. 98; R78 for the details). The insurer, being obliged to make loans on the policies only to the extent of their existing loan values, was therefore free to refuse to make any loan on the policies for the benefit of the insured *whose equities in the policies had been extinguished by his receipt of the proceeds of his own fraud.*" (Insert in parenthesis and also the italics supplied.)

In the first place, the policy clause on which the Court below relied (quoted in the opinion), did not refer to any indebtedness that the assured had above to the insurer by reason of any wrong committed by the assured in obtaining disability benefits fraudulently. Such an indebtedness is one created *outside* of the policy. A debt created "*on the policy,*" referred to in the policy clause, would be either a loan made by the insurer to the assured, or an assignment of rights thereunder given to the insurer by the assured or the beneficiary, neither of which types of debt "on the policy," of course, were involved here. That policy clause has no application to a claim for a debt by reason of disability benefits fraudulently obtained by the assured (see Point I, and cases there discussed).

But it is not necessary to interpret that clause, for the purposes of this case, because even if it could be so distorted as to sustain the construction given it by the Court below, *it would be contrary to the provisions of New York State Insurance Law*, Section 166 (1) (5), *as construed by the State's highest court, and therefore, the rights of the parties would not be controlled thereby*, but by the provisions of *Insurance Law*, Section 166. This is expressly provided by *New York State Insurance Law*, Section 143. (See also cases cited in Point I.)

In *Whitefield v. Aetna Life Ins. Co.*, 205 U. S. 489 discussed below, p. 40), this Court said under like circumstances (p. 496):

> "Any contract (of life insurance) inconsistent with the statute must be held void."

As in *Insurance Law*, Section 166 (1) (5), the cash loan value of the policies were exempt from the claim of the insurer for disability benefits wrongfully obtained by the assured (see cases in Point I), the cash loan value of the policies remained unimpaired at the time that the assured and the bank asked the insurer for a loan on the policies, which it refused to make. The statute says so expressly.

At the time the bank and the assured made demands for the loan, there then being sufficient cash loan value in the policies to meet the assured's obligations to the bank, and the policies being undisputably "in full force and effect," the loan should have been made as requested.

If the loan had been made, as requested, there would have been no occasion for inducing the bank to surrender the policies.

The decision of the Court below is, therefore, squarely contrary to the statute and decisions of the State of New York, which, of course, should have been the rule of decision in the Federal courts. *U. S. C. Article 28*, Section 1652. *Whitefield v. Aetna Life Ins. Co.*, 205 U. S. 489.

POINT III.

As the assured's debt for disability benefits wrongfully obtained, by express New York State statutory provisions and decisions of the state's highest court could not be used to diminish any of the rights of the beneficiary under the policies, the Federal Court had no power, even on the theory of equity, to bar the beneficiary from maintaining her action, merely because the insurer was not repaid the indebtedness, for this would be doing indirectly what the statute expressly says could not be done at all in law or equity.

New York Insurance Law, Section 166(1) (5) holds that the death benefits payable to the third party beneficiary may not be diminished, or in any wise, impaired by any indebtedness of any creditor of the assured, and the highest court of the State of New York has held that an insurer may not in any wise impair the monetary benefits under the policies payable to the assured, or the beneficiary, by a claim it has for disability benefits fraudulently obtained (see Point I, *supra*).

Therefore, to deprive the beneficiary of her right to come into a Federal Court to enforce her right to the death benefits under the policies, and to reinstate the policies whose surrender was wrongfully obtained, on the ground that it is inequitable to permit her to enforce her rights where the assured's debt for the disability benefits has not been repaid to the insurer, *not only diminishes her rights under the policies, contrary to the New York statute, but actually destroys her rights*, contrary to New York statute.

In *Whitefield v. Aetna Life Ins. Co.*, 205 U. S. 489, a Missouri statute provided, that, under circumstances such as there existed, suicide "shall be no defense" to a claim for death benefits under a life insurance policy. The policy itself provided that, in the event of suicide, the insurer shall be liable only for "one tenth" of the

face of the policy. The Circuit Court of Appeals, Eighth Circuit, ruled that what the statute meant was that suicide shall not be a complete defense to a death claim on the policy, and that, therefore, the provision in the policy to pay a lesser amount on suicide was not contrary to the statute. This decision, however, was contrary to the State Insurance Statute as construed by the decisions of the State Courts. This Court granted certiorari and reversed the judgment, holding that the practice followed by the Circuit Court, in failing to follow the statute as construed by the State Courts, was improper, and made an observation which squarely fits here (p. 496):

> "In this way the statute could be annulled or made useless for any practical purpose."

The case at bar involves a similar basic principle of law as to insurance policies, the rights of the holders of which are vitally effected in a greater degree than in the *Whitefield* case, because there are comparatively few instances where an assured commits suicide, whereas, the large majorities of assureds at one time or another will desire to make a loan on the policy, or will want to make a claim for disability benefits, and where the insurer is given the right to act as cavalierely as it did in this case, in disregard of the state's statutes and the state's decisions, the policies of the assured are practically nullified.

It was argued in the *Whitefield* case, that the statute "seemingly encourages suicide and offers a bounty therefor, payable, not out of the public funds of the State, but out of the funds of insurance companies." This Court rejected that contention as a ground for ignoring the provisions of the State statute as construed by the State Courts, and said (p. 495):

> "An insurance company is not bound to make a contract which is attended by the results indicated by the statute in question. If it does business at all in the State, it must do so subject to such valid regulations as the State may choose to

adopt. Even if the statute in question could be fairly regarded by the court as inconsistent with public policy or sound morality, it cannot for that reason alone be disregarded; for it is the province of the State, by its legislature, to adopt such a policy as it deems best, provided it does not, in so doing, come into conflict with the constitution of the State or the constitution of the United States. There is no such conflict here. The legislative will, within the limits stated, must be respected if all that can be said is that, in the opinion of the court, the statute expressing that will is unwise from the standpoint of the public interests. See *Northwestern Life Ins. Co. v. Riggs*, 203 U. S. 243."

POINT IV.

The Circuit Court's failure to give the beneficiary the benefit of the statutory provisions of the New York Insurance Law, and of the decisions of the state's highest court, deprived her of the benefits of those statutes and decisions, and of the benefits of U. S. C. Article 28, Section 1652, and her constitutional right to due process of law.

The opinion written by the District Court shows that by giving the beneficiary the rights that she is entitled to, as a matter of law, under *Insurance Law*, Section 166(1) (5), and the decisions of the highest court in relation to those rights, she was entitled to have the policies reinstated, and to receive the death benefits therein, in accordance with its terms (see Point I, *supra*).

The Court of Appeals completely ignored the provisions of *Insurance Law*, Section 166(1) (5), and the decisions of the New York courts insofar as they settled the policy rights that are protected thereunder, and, instead, relied on a policy provision which actually has nothing to do with the issues in this case, and even if it had, would

have to be rejected as a matter of law, for it would be then under an interpretation in conflict with the provisions of the above cited section of the Insurance Law, and would have no effect by the express provisions of *New York Insurance Law*, Section 143. *Whitefield v. Aetna Life Ins. Co.*, 205 U. S. 489.

Both of the reasons that the Court below gave for dismissing the complaint are squarely contrary to the rights that the beneficiary had under *Insurance Law*, Section 166 (1) (5), which statute was provided for the protection of just such rights of the widow of the assured as are here involved.

Certainly, the failure to give her the protection of those rights, and of the State Court decision in relation to those rights, which would inevitably have required an affirmance of the judgment rendered by the District Court, was depriving her of her rights under those statutes and decisions of New York State and of *U. S. C. Title 28*, Section 1652, and her constitutional right to due process of law. *Whitefield v. Aetna Life Ins. Co.*, 205 U. S. 489 (discussed, *supra*, pp. 39 and 40).

POINT V.

The decision of the Court of Appeals of the Second District is contrary to the decision of the Circuit Court for the Seventh Circuit, that a policy whose surrender was wrongfully obtained may be reinstated in an action by the beneficiary and the death benefits granted her, less the amount of the money paid to the bank for the surrender, and less the premiums which had remained unpaid up to the time of the assured's death.

In the case of *Missouri State Life Ins. Co. v. Langreader*, 87 Fed. (2) 810 (C.C.A. 7), the bank assignee of a life insurance policy, in which the wife of the assured was the beneficiary, surrendered the policy to the insurer for an amount paid by the insurer. In an action brought

by the beneficiary, exactly as in the case at bar, the Court held that the surrender had been wrongfully obtained from the bank, reinstated the policy, and granted the beneficiary the death benefits thereunder, less the amount paid to the bank at the time of the surrender, and less the amount of the premiums that had remained unpaid at the time of the assured's death. That was an action at equity, exactly as in the case at bar.

In the *Langreader* case, even though the assured himself had given oral instructions to surrender the policy, it was held the surrender had been wrongfully obtained, by failure of the insurer to give proper notice to the assured, or to the beneficiary, of "the time and manner" at which the surrender was to be made, so that they were not given an opportunity to take steps to prevent the surrender being effectuated. No duress or misrepresentation was used by the insurer to effect the surrender. In the case at bar, likewise, no such notice was given by the insurer (Com. Par. 111, R84), and, in addition, the assured wrongfully declared the policies lapsed, wrongfully withheld a loan thereon, and made misrepresentations as to the rights and liabilities of the assured, the beneficiary and the assignee bank, all contrary to protest and warnings of the assured, the beneficiary and the bank.

In other words, this is an *a fortiorari* case, and yet, the Court of Appeals, Second Circuit, rendered a decision directly contrary to that rendered by the Seventh Circuit in the *Langreader* case.

This creates a conflict in the Federal Courts of Appeal as to a principle of law which is of vital importance to all holders of policies, including assureds, beneficiaries and assignees.

POINT VI.

The decision rendered by the Court of Appeals that the beneficiary may not maintain an action to reinstate the policies, whose surrender was wrongfully obtained by the insurer by wrongfully withholding a loan and by misrepresenting the rights and liabilities of the assureds, the beneficiary, the bank assignee, and the insurer, is contrary to the decisions of the highest court of every state in the Union which has passed on that question.

The highest courts of many states of the union have had occasion to pass on whether a beneficiary may obtain the reinstatement of policies where their surrender was wrongfully obtained by the insurer, either by misrepresentation as to the rights under the policies, or by other wrongful or inequitable conduct on the part of the insurer, and unanimously they have held that the beneficiary is entitled to recover in such an action.

Casper v. Bankers Life Ins. Co., 238 Mich. 300.
Penn Mutual Life Ins. Co. v. Ashton, 93 F. (2) 565, p. 568 (C.C.A. 10).
American Nat. Ins. Co. v. Yee Lum Shee, 104 F. (2) 688, p. 694-5 (C.C.A. 9), certiorari denied 308 U. S. 592.
Conservative Life Ins. Co. v. Hutchinson, 52 S. W. (2) 709, 244 Ky. 706.
Glickman v. New York Life Ins. Co., 16 Cal. (2) 626.
Knauer v. Globe Mutual Life Ins. Co., 48 N. Y. Super. Ct. (16 Jones & S.) 454.
Pearson v. Mut. Life Ins. Co., 17 Tenn. App. 503 (1935); 68 S. W. (2) 963.
Stark v. Equitable Life Ass. Soc., 205 Minn. 138 (1939).
Tabor v. Mich. Mut. Life Ins. Co., 44 Mich. 324.
Sovereign Camp W. W. v. Duncan, 269 Ky. 673 (1937.)
Heinlein v. Imperial Life Ins. Co., 101 Mich. 250.
Riddle v. Rankin, 146 Kan. 530.
Neely v. Industrial Life and Health Ins. Co., 192 S. C. 71 (1939).

Hamilton v. Mut. Reserve Life Ins. Co., 2 Ont. Week, Rep. 806.
Fritz v. National Serv. Life Soc., 175 N. Y. S. 479 (App. Term) (not officially reported).
New York Life Ins. Co. v. Jackson, 18 Ga. App. 494.
State Life Ins. Co. v. Barnes, 58 S. W. (2) 189 (Tex. Civ. App.).
Merchants & B. Glee. Co. v. Downs, 128 Fla. 767 (1937), p. 785.

See also:

Holden v. Pulman Fire Ins. Co., 46 N. Y. 1.
Hudson v. Glens Falls Ins. Co., 218 N. Y. 133.
Barry v. American Central Ins. Co., 132 N. Y. 49.

POINT VII.

This Court does not appear to have passed on the issues presented herein.

A diligent search has failed to disclose a single case of this Court passing on the issues here presented with respect to the right to the beneficiary to reinstate policies of life insurance, whose surrender was wrongfully obtained, and to collect the death benefits thereon under the circumstances of fact and law which are here presented.

The respondent cited the case of *Mutual Life Ins. Co. v. Phinney*, 178 U. S. 327. That, however, was *an action at law*, brought by the assured's executrix to recover the death benefits on a policy that the assured had himself abandoned, *without either of them having first brought any proceeding in equity to reinstate the policy.* The assured had failed to pay two successive annual premiums, and had given the policy to the insurer's agent, with the observation that he had no further use for it.

The insurer had interposed the defense that the policy had been abandoned.

A claim was there made by the executrix of the assured's estate, that the abandonment defense was invalid because, under a provision of the then New York Insurance Law, the insurer could not declare a policy lapsed or forfeited after nonpayment of premium, unless after default in premium payment, a notice was given the assured, calling his attention thereto, and giving him 30 days in which to pay the premium, and by reason of the further fact that the insurer's agent had told the assured that, in his opinion, the policy had lapsed, without mentioning to the assured, the existence of that New York notice statute.

This Court there held that, for the purposes of deciding that appeal, the opinion of the insurer's agent, and even the correct interpretation of the law itself on the question of notice, were "immaterial," for in the State of Washington, where the trial was taking place, in the District Court in the City of Seattle, the New York statute constituted foreign law, and was a fact, together with the other facts in the case, to be considered by the jury, on the question of whether there was a voluntary abandonment agreed to by the assured and the insurer, or whether it was wrongfully induced by any misrepresentations on the part of the insurer. This Court further held that a voluntary abandonment, fairly agreed to, does not constitute a declaration of forfeiture or lapse by the insurer, such as was barred by the statute, whatever its legal interpretation would be. This Court thereupon sent the case back for a new trial, solely on the ground that it was material error for the Trial Court to have refused to charge the jury, as requested by the defendant, that if the parties voluntarily agreed to abandon the policy, without any coercion or misrepresentation on the part of the insurer, such abandonment agreement is valid and terminates the policy.

In the case at bar, the wrongful withholding of the loan and the various material misrepresentations, where-

by the insurer induced the surrender of the policies by the bank, are established by the undisputed facts, and by the settled law of the State of New York, in which state the trial itself took place. Furthermore, the Court below ignored Insurance Law, Section 166 (1) (5) and the decisions of the State's highest court, and also the provisions of U. S. C. Title 28, Section 1652, and deprived the beneficiary of due process of law.

Furthermore, the provisions of Insurance Law, §166 (1) (5) constitute the very heart of this case. See *Whitefield v. Aetna Life Insurance Co.*, 205 U. S. 489, unlike the insurance section that was involved in the *Phinney* case.

Besides, in the *Phinney* case, an action *at law*, the policy could not be reinstated; and no recovery could be had in a law action under the provisions of an abandoned policy. This Court, therefore, had no occasion, in that case, to pass on the question of whether in an *equity action*, upon proof that the surrender was induced by misrepresentation and duress, the policy should have been reinstated, or whether a Federal Court may ignore the statutory provisions and court decisions of a state, in which the trial takes place, which is the crux of this case.

The decision in the *Phinney* case has no application to the case at bar, where these issues are squarely raised in an action *at equity*, brought for the very purpose of reinstating the policy, because its surrender was obtained by the insurer's material misrepresentations and wrongful withholding of a loan. The distinction between the rule involved in the *Phinney* case and that here applicable was squarely pointed out in the case of *Staten Island Hygeia I. & C. S. Co. v. U. S.*, 83 Fed. (2) 68, p. 71 (C. C. A. 2), reversing 9 Fed. Supp. 746 (which on p. 752 relied on the *Phinney* case, *supra*, among other like cases), where the Circuit Court laid down the applicable rule that in an action in equity, such equitable

relief should be granted, where applicable, and, in declining to follow the decision in the *Phinney* case, which was rendered in an action *at law*, the Court said:

> "Between private parties it seems to be well established that equitable relief may be had where a mistake as to the plaintiff's legal rights is induced by misrepresentations, even though innocently made, if it is reasonable for the plaintiff to rely upon the presumptively greater knowledge of the defendants. See *Snell v. Insurance Company*, 98 U. S. 85, p. 89; *Order of United Commercial Travelers v. McAdam*, 125 F. 358, p. 369 (C.C.A. 8); *Berry v. American Central Insurance Co.*, 132 N. Y. 49."

To like effect see:

Order of United Commercial Travelers v. McAdam, 125 Fed. 358 (C.C.A. 8).
Penn Mutual Life Ins. Co. v. Ashton, 93 F. (2) 565 (C.C.A. 10).
Berry v. American Central Ins. Co., 132 N. Y. 49.
Hudson v. Glens Falls Ins. Co., 218 N. Y. 133, at 138 and 139.
Sovereign Camp WW v. Duncan, 269 Ky. 673, p. 679.
Lansdowne v. Lansdowne, 2 Jacob & W 205, 37 Eng. Rep. Reprints 605.
Haviland v. Willets, 141 N. Y. 35, p. 50.
Fidelity & Deposit Co. of Md. v. McQuade, 123 F. (2) 337, p. 339 (C.C.A.:DC.).
Fidelity & Deposit Co. v. Penn Greyhound Bus, 123 F. (2) 548, p. 550-51.
Cooke v. Nathan, 16 Barbour (N. Y.) 342.

See also:

Snell v. A. F. & M. Ins. Co., 98 U. S. 85, p. 89.
Chicago Ry. Co. v. DesMoines, etc. Ry., 254 U. S. 196, p. 218.

Here the misrepresentation by the insurer, which induced the surrender of the policies was of fact and law, and, in addition, there was the wrongful withholding of a loan on the policy, which is duress.

CONCLUSION.

It is respectfully submitted that a writ of certiorari should issue from this Court, to review the decision of the United States Court of Appeals for the Second Circuit, and that this Court should, upon petition for certiorari, reverse the judgment of the Circuit Court for the Second Circuit and reinstate the judgment of the District Court for the Southern District, or remand the cause with proper instructions to the Court below.

Respectfully submitted,

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No. 424

Office - Supreme Court, U.
DEC 17 1951

Supreme Court of the United States

ELLA FRAD,

Plaintiff-Petitioner,

against

THE COLUMBIAN NATIONAL LIFE INSURANCE COMPANY,

Defendant-Respondent,

against

ELLA FRAD, as Executrix under the Last Will and Testament of William D. Frad, deceased,

Third Party Defendant.

RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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Respondent respectfully submits that the case at bar is unique in its facts; the ruling of the Court of Appeals is narrow in its application; there is nothing to warrant special attention by this Court; and finally, the point has been reached, at long last, when this litigation should be permitted to come to an end.

The Facts.

The evidence produced at the trial showed that in 1928 and 1929, defendant issued to William D. Frad, three policies of life insurance which provided, all together, for the payment of $20,000 to Ella Frad, his wife, upon his death; and for the waiver of premiums and payment of $200 a month in the event of his total and permanent

disability (Pltf's Exs. 5, 6 and 7; admitted p. 163, printed p. 262-5). In his application for each of these policies, Frad represented that he was a clothing salesman.

In November 1935, Frad made claim for disability benefits, asserting that he was totally and permanently disabled by a heart condition (ff. 820-825). Investigation of this claim then revealed that Frad was not a clothing salesman but an international cardsharp who had spent the past two years in the Federal Penitentiary for having obtained and used false United States passports in the name of "Frederick Warren Gorham," and a false Canadian passport in the name of "Daniel Edward Swift" (ff. 1159-1160; 1439-1440).

Although defendant would, no doubt, have refused to issue the policies had it known that Frad was a cardsharp, the policies had become incontestable and therefore on the advice of its examining physician that the insured had a serious heart condition (f. 852), defendant approved the claim (f. 830), waived premiums, and paid disability benefits from January 1936 through July 1937 (Deft's Ex. II; admitted p. 207, printed p. 397).

When defendant then learned that Frad had taken more than $30,000 from a man named Richter on the SS *Santa Rosa* in October 1936, and had probably participated in still another card game (ff. 1058, 1347-1350), it refused to pay further disability benefits (ff. 97-100). Thereupon Frad brought suit in the City Court of the City of New York to compel defendant to continue the disability payments, but, before the action could be brought on for trial, he was returned to the Federal Penitentiary where he remained until the spring of 1939 (ff. 1056-1058; 1439-1440; 1451, 659 and 662). Upon his release, his action was brought on for trial in the City Court and settled by the payment of $4,696.55 in compromise of accrued benefits of some $6,000 (ff. 809-812); and defendant thereupon re-

opened the claim, waived premiums, and paid disability benefits until April 1940 (f. 1191).

Upon receipt of information that Frad had again engaged in card games for money, defendant, for the second time, terminated its payments (ff. 115-117, 1351-1353), and Frad once more brought suit to compel defendant to continue the payments. This time the Municipal Court of the City of New York was the forum and defendant not only denied its liability to pay further benefits but asserted a counterclaim for the recovery of the benefits which it had already paid (ff. 756-764).

An intensive and singularly successful investigation was then undertaken by defendant which yielded an impressive amount of evidence concerning the activities in which Frad had been engaged while collecting disability benefits and enjoying a waiver of premium (ff. 632-637). This evidence, which has been collated in defendant's exhibits GG-1 and GG-2 (admitted p. 205, printed pp. 393-4), indicated that from 1929 to 1942, Frad's constant occupation when not under Federal detention had been to cheat at cards for high stakes. Although the pattern of his operations was always the same, he underwent several changes of identity in the process, and with each change associated himself with a new set of companions.

From May 1929 to June 1931, travelling under a false United States passport, he worked the North Atlantic as "Frederick Warren Gorham" of the Gorham Silver Company. His companions were Messrs. Davis, Mull and Schwartz (Deft's Exs. GG-1). Colonel John C. Minor, who lost $19,090.80 at "old fashioned bridge" on board the SS *Paris* in June 1929, was one of the victims of this period (ff. 509-534), which was brought to an end by Frad's first indictment for passport frauds on June 16, 1931 (f. 1438).

From June 1932, to November 1933, travelling under a false Canadian passport, Frad continued to work the North Atlantic, but now he was "Daniel Edward Swift", a Cana-

dian meat packer (f. 1160), and his companions were Messrs. Ashcroft, Buttolph and Bowen (Deft's Ex. GG-1). This period was brought to an end in February 1934, by his second indictment (f. 1439), arrest and conviction (ff. 659-660).

For a few months in 1936 after his release from the Federal Penitentiary, Frad sailed under his own name with several of his old companions on vessels cruising to the Caribbean and to California (Deft's Ex. GG-2). This gave him an opportunity to take nearly $32,000 from Francis G. Landon on the SS *Rotterdam* in August 1936 (ff. 1201-1203), and to "win" $36,000 (later compromised at $18,000) from Paul K. Richter on the SS *Santa Rosa* in October 1936 (ff. 686-687, 1056-1058). This brief interlude under his own name was terminated when the insured was arraigned and remanded for violation of his parole in November 1936 (f. 660), but this did not put an end to his depredations for he sued out a writ of habeas corpus which was sustained and then, while the case was taken first to the United States Court of Appeals for the Second Circuit (*Kelly, Marshall* v. *United States ex rel Frad,* 89 F. 2d, 865), and then to this Court (*Frad* v. *Kelly,* 302 U. S. 312), he resumed his activities as "Daniel Fulton", millionaire operator from Oklahoma. "Fulton" was even more successful than "Gorham" and "Swift" had been in taking substantial sums of money from elderly gentlemen at crooked cards. With the assistance of Messrs. Hudson and Daly (Deft's Ex. GG-2), "Fulton" took $13,300 from William T. Dowling on board the SS *Columbus* in April 1937 (ff. 1204-1217); $96,000 from George A. Ball on board the SS *Reliance* in June 1937 (Deft's Ex. GG-2; ff. 682, 1440); $47,000 from Alexander Glass in September 1947 (Deft's Ex. GG-2; ff. 683-684); and $6,217 from Professor Charles Cheney Hyde on board the SS *Columbus* in October 1937 (Deft's Ex. GG-2; f. 1218). This very lucrative period came to an end in November 1937 when this Court sus-

tained the order of the Court of Appeals and "Fulton" returned to the Federal penitentiary to serve the balance of Frad's sentence (*Frad* v. *Kelly, supra*).

Released again in the spring of 1939 (f. 661), Frad immediately picked up where he had left off and, once more using the name of "Daniel Fulton", renewed his Caribbean cruises (Deft's Ex. GG-2). It was on one of these cruises, on the SS *Nieuw Amsterdam* in February 1940, that he took notes for $3,200 from C. Stowe Spencer (ff. 1263-1286), and for $3,125 from George A. Wedge (ff. 1240-1262). A few months earlier, in November 1939, assisted by Messrs. Raphael, Daly and Darnell, he had taken $15,925 from Frederick R. Sears at the Ambassador Hotel in New York (ff. 1287-1310); and in the following autumn, again with Darnell's assistance, he took some $15,000 from Eugene S. Halle at the Hotel Claridge in Atlantic City (ff. 1311-1343). How Frad fared thereafter the record does not reveal, except that he experienced at least one final change of name when he became "Thomas F. Hunt" who frequented fashionable hotels along the Atlantic seaboard (Deft's Ex. GG-2).

When all of this information had come into its possession in the late summer and early fall of 1942 (ff. 632 and 638), defendant amended its answer in the Municipal Court action so as to plead, as an equitable defense, that the policies had lapsed for non-payment of the premiums which had been erroneously waived in reliance upon the insured's representation that he was totally disabled (ff. 1418-1422), but at the trial of the Municipal Court action, this defense was struck out upon the ground that the Court lacked jurisdiction to entertain an equitable defense (ff. 625-626). Accordingly, the questions put to the jury were (1) whether the insured was disabled in April, May and June 1940, so as to be entitled to $600 in disability benefits, and (2) whether he had collected benefits for earlier periods when he was not entitled to them so as to be

liable on defendant's counterclaim for their recovery. The jury answered each of these questions in the negative but, on appeal, the judgment was vacated, in so far as it dismissed defendant's counterclaim, and the counterclaim was remanded for retrial (*Frad* v. *Columbian*, New York Law Journal, Vol. 109, 4/22/43, page 1562; *Frad* v. *Columbian*, New York Law Journal, Vol. 109, 6/17/43, page 2368). Instead of being re-tried, however, the counterclaim was discontinued (*Frad* v. *Columbian*, New York Law Journal, Vol. 111, 2/18/44, page 658), and reasserted in the action at bar.

This concludes the story of the issuance of the policies to the supposed clothing salesman in 1928 and 1929; the payment of disability benefits and the waiver of premiums for long periods of time when, unknown to the Company, he was engaged under various aliases and with various confederates in making thousands upon thousands of dollars at his usual and chosen occupation; the settlement of the City Court action for want of evidence to defend it; and, finally, the defeat of the Municipal Court action by the overwhelming evidence which was eventually marshalled against him.

A general knowledge of these events is essential to an understanding of the facts leading up to the surrender of the policies and the institution of the present litigation.

In January 1941, Frad applied to the Colonial Trust Company for a loan to be secured by the policies. The Municipal Court action was pending at that time but no claim had then been made that the policies had lapsed for non-payment of premiums erroneously waived, for the defendant had not then uncovered the evidence of Frad's activities which has been described above. Accordingly, when the Trust Company made inquiry of defendant concerning the status of the policies, it was informed that each policy was in force with no premiums in arrears and no loans outstanding, and that the loan and cash surrender

values exceeded the loan sought by the insured (ff. 118-131). Upon receipt of this information, the Trust Company loaned Frad $4,000 (subsequently increased to $6,300) on the security of the policies (ff. 174-176). The form of collateral assignment which was used for this purpose gave the Trust Company the *sole* right to surrender the policies and receive the cash values at any time. It also gave the Trust Company the *sole* right to obtain loans on the policies. Further, it authorized the insurer to recognize the assignee's claim to rights under the assignment without investigating the reason for any action taken by the assignee. In this same connection, it provided that the *sole* signature of the assignee would suffice for the exercise of any rights under the policies, that the *sole* receipt of the assignee of any sums received should be a full discharge and release to the insurer, and that checks for any sums payable under the policies should be drawn to the *exclusive* order of the assignee (ff. 1061-1076).

In September 1942, which was about a year and eight months after the loan was made, defendant, having uncovered Frad's very lucrative activities, amended its answer to the complaint in the Municipal Court action so as to allege that the policies had lapsed for non-payment of the premiums of which it had been defrauded. This, quite naturally, alarmed the Trust Company, which took the position that, as to it, defendant was estopped to claim that the policies had lapsed for non-payment of premiums (ff. 175-176).

On January 17, 1943, the loan went into default which, of course, made it necessary for the Trust Company to take some affirmative action. Having endeavored, in vain, to persuade defendant to recognize the estoppel which it claimed, or to make some other arrangement satisfactory to it (ff. 174-180; 1105-1121), the Trust Company, finally, made an absolute and unequivocal demand upon defendant for the cash surrender values of the policies (ff. 1147-1153).

Defendant complied with the demand (ff. 1156-1158). Soon afterwards Frad commenced the present action to have the transaction construed as if, instead of having been a payment of cash surrender values to the Trust Company, it had been a loan made to him on the security of the policies. He did not join the Trust Company as a party to the litigation.

One other phase of the matter should be mentioned before we turn to points of law raised by the pending petition. The beneficiary of the life insurance policies was the wife of the insured. After his death, she became the plaintiff in the action in her own right as beneficiary, and she is now the one who petitions for a writ of certiorari. She knew that her husband travelled under false passports; she knew that his occupation was to play cards for money; she was acquainted with the men who accompanied him on his card playing trips; she was familiar with the arrangement between her husband and his companions for the division of their "winnings"; she kept large amounts of cash for him in a safe deposit box; she knew he used assumed names in pursuing his occupation, and she, herself, used an assumed name in maintaining a safe deposit box to which he had access; she knew the names of quite a number of the men who were his victims (ff. 642-701, 703). When her husband was away on trips, it was she who endorsed his disability checks and deposited them in a joint account which she maintained with him (ff. 675-676, 1189-1191). In short, she was perfectly aware that he was gainfully employed at his usual occupation while collecting disability benefits from defendant and enjoying a waiver of premiums. She even assisted him in collecting the disability benefits, and she personally profited by the fraud.

Opinions Below.

On the foregoing evidence, the District Court held that defendant was entitled to recover from the estate of the insured (which was bankrupt) the disability benefits of

which it had been defrauded and the premiums which it had been fraudulently induced to waive. At the same time, the Court held that the beneficiary, who now petitions for certiorari, was entitled to recover the face amount of the insured's policies, less the cash surrender values which had been paid to the Trust Company and the premiums which had neither been paid nor waived. The heart of the decision, we believe, was the holding that once premiums have been waived, the only recourse open to the insurer, when it finds that it has been defrauded, is to bring an action against the insured as for a debt; and that it cannot declare the policies lapsed for non-payment of premium. This, we respectfully submit, is neither good law nor good sense.

On appeal, the Court of Appeals for the Second Circuit unanimously reversed the District Court and dismissed the complaint upon the ground (1) that the insurer could not have been compelled to make a loan to the Trust Company or to any one else, for the loan values of the policies had been exhausted by the insured's fraud; and (2) that neither the insured nor the beneficiary, who had kept the policies in force by fraudulently inducing the insurer to waive the premiums, came to the Court with clean hands and, hence, neither of them was entitled to have the policies reinstated.

POINT I.

There is no novel or substantial question which requires this Court's review.

Fortunately for the life insurance industry there can only be one William D. Frad, and he is dead. Fortunately, also, the litigation which he occasioned is essentially unique. Petitioner's contention that the decision of the Court of Appeals has swept away the rights of all insured persons, their assignees and beneficiaries, is patently absurd. What

petitioner's counsel is really trying to do is to induce this Court to assume the function of the Court of Appeals of the State of New York because her judgment has been reversed, but he is unable to assign any unusual or compelling circumstances to justify such a course. His plea that the Court below failed to follow the statutory and common law of the State of New York is no different from the plea which is always presented to an appellate court and has in it no factor which calls for special consideration by the United States Supreme Court.

POINT II.

The decision of the Court of Appeals does not conflict with the statutory law of the State of New York.

Over and over again in the petition and brief our opponent contends that the decision of the Court of Appeals violated Section 155(g) of the Insurance Law of the State of New York which requires insurers to lend money within the limits of the cash values of their policies.

Over and over again our opponent also contends that the decision violates Section 166(1)(5) of the Insurance Law which protects the "proceeds and avails" of life insurance policies for the benefit of third party beneficiaries as against the claims of creditors of the insured.

The answer to these contentions, as Judge CHASE so clearly puts it, is that each of the policies which are the subject of the present litigation expressly provides that *any* indebtedness to the Company on the policy will diminish the cash and loan values. In other words, in the language of Section 166(1), the "proceeds and avails" are to be determined only after the insured's indebtedness to the Company has been deducted. In the case at bar, the "proceeds and avails" must be identified as of the time when, if ever, defendant should have made a loan to the Trust

Company. This, of course, limits them to the cash and loan values, for the insured was then alive and the policies had not then matured as death claims.

Unlike the insured, the beneficiary never had any interest in the cash and loan values and, consequently, Section 166(1)(5) of the Insurance Law was not called into play. It could not protect her interest because she had none at that time. It did not even purport to protect his interest.

The insured, of course, would have had an interest in the cash and loan values, had they not been previously exhausted by his indebtedness to the Company. Because of this indebtedness, however, there was no obligation to make a loan to him or to make a loan for his benefit and, consequently, Section 155(g) of the Insurance Law was not violated. As Judge CHASE puts it:

> "The insurer, being obliged to make loans on the policies only to the extent of their existing loan values, was therefore free to refuse to make any loan on the policies for the benefit of the insured whose equities in the policies had been extinguished by his receipt of the proceeds of his own fraud" (p. 542).

Accordingly, we perceive no violation of the statutory law of the State of New York upon which the petitioner so heavily relies.

POINT III.

The decision of the Court of Appeals does not conflict with the case law of the State of New York.

Over and over again in the petition and brief our opponent contends that the decision of the Court of Appeals is contrary to the decisions of the courts of the State of New York, and, more particularly, runs counter to *Wilkes* v. *Equitable Life Assurance Society*, 262 App. Div. 73, modified 289 N. Y. 63; *Standard* v. *Equitable Life*, N. Y. Law

Journal 3/7/36 p. 1197, aff'd 247 App. Div. 617, aff'd 274 N. Y. 519; *Orent* v. *Equitable Life*, 268 App. Div. 299; and *Grauer* v. *Equitable Life*, 167 Misc. 30.

Our denial of this contention is twofold: first, the *Wilkes, Standard, Orent* and *Grauer* cases do not support the proposition for which our opponent cites them; and, second, the decision of the Court of Appeals does not conflict with them but, on the contrary, cites them correctly.

At page 12 of the petition, our opponent cites the foregoing cases for the proposition that "where an assured obtains disability benefits from an insurer by fraud * * * the insurer has a claim for debt as a creditor against the assured, but * * * this claim, just as any claim of any other creditor, is barred from being offset against the policies, or beneficial rights or interests therein of the assured or the beneficiary." In our opinion, these cases stand for no such proposition. They do not limit the insurer to a claim for debt as a creditor. Neither do they relate to the offset of claims against policies. The proposition for which they stand, and for which Judge CHASE correctly cited them on page 541 of his opinion, is that life insurance policies cannot be lapsed by the unilateral act of the insurer but only after the insurer has given the insured a new, reasonable time, fixed by the Court, within which to pay the arrears of premium.

Moreover, the cases in question should also be distinguished on their facts from the case at bar. In the case at bar, instead of meeting his obligation, fixed by contract, to pay premiums at stated intervals, the insured deliberately elected to defraud the Company by falsely contending that he was disabled. In the cited cases, with the exception of the *Orent* case, there was no fraudulent representation that the insured was disabled but only a claim that he had made some material misrepresentation, when, many years earlier, he applied for his insurance, and that, by reason of such misrepresentation, the insurer was entitled to rescind the disability coverage and retroactively

annul the waiver of premiums. In such circumstances, the New York courts have held that the insurer must prove the material misrepresentation before the insured can be called upon to pay the arrears of premium. To put the distinction another way, in the case at bar, the insured avoided his obligation to pay premiums by fraudulently representing that he was totally disabled, whereas in the cited cases, it was claimed that he had made a material misrepresentation when, originally, he applied for the insurance.

The *Orent* case, however, was like the case at bar in that the insured obtained a waiver of premiums by fraudulently representing that he was totally disabled. That case may nevertheless be distinguished because, when the insurer granted the waiver of premiums to *Orent*, it had ample notice of his fraud but, for reasons sufficient to itself, elected to continue to pay the disability benefits.

Accordingly, we perceive no conflict between the decision of the Court of Appeals in the case at bar and the decisions of the New York courts in the cases so frequently cited and so heavily relied upon by the petitioner.

POINT IV.

The decision of the Court of Appeals does not conflict with *Missouri State Life Ins. Co.* v. *Langreder.*

Over and over again in the petition and brief our opponent contends that the decision of the Court of Appeals conflicts with the decision of the Seventh Circuit in *Missouri State Life Ins. Co.* v. *Langreder*, 87 F. (2d) 810.

The short answer to this contention is simply to refer the Court to Judge CHASE's opinion at the top of page 542 in which he indicates, quite clearly, that it is not the intention of the Court to take issue with that case. Furthermore, it must be obvious that, since the *Langreder* decision was devoted to the interpretation of Illinois law, any conflict be-

tween that decision and the decision of the Second Circuit interpreting New York law would not be the type of conflict which should interest or concern this Court.

POINT V.

The Court of Appeals correctly held that the petitioner was not entitled to equitable relief.

As a second and quite independent reason for the dismissal of the complaint the Court of Appeals held that, since the insured and the beneficiary had defrauded the insurer and had retained the fruits of the fraud, the beneficiary (the insured having died) was no proper person to seek affirmative equitable relief.

It could not be gainsaid that the policies had, in fact, been surrendered or that without the intervention of a court of equity, they could never mature as death claims. As Judge CHASE pointed out in the concluding paragraph of his opinion, it is a fundamental rule that one who comes into equity must do so with clean hands. In this case nothing could be more clear then that both the insured and the beneficiary came to the court with unclean hands. Therefore, even if there were any merit to the petitioner's contentions, which we have just reviewed, the clean hands doctrine would, alone, suffice to sustain the decision of the Court of Appeals.

We make no special comment on Point VI of the petitioner's brief except to call the attention of the Court to the fact that in each one of the cases there cited the insurer was guilty of gross fraud in effecting the surrender of a policy of life insurance, whereas, in the case at bar, there is no proof and no finding that the insurer practiced any fraud of any kind but only that it asserted legal rights in the policies in contravention of rights claimed by the insured and the assignee.

CONCLUSION.

The petition for certiorari should be denied.

Dated: December 14, 1951.

Respectfully submitted,

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